MONETARY STANDARDS.

THE purpose of this paper is to examine some of the arguments advanced in an article on "Monetary Standards" by Mr. John Cummings in the JOURNAL for June 1894. The article is of itself well worthy of a reply, and representing as it does the views of a widely recognized school of economic writers, it is rendered still more worthy of attention.

The first five pages are taken up with a discussion as to the power which fixes the standard of deferred payments, and the conclusion is reached that "the selection of the standard is the voluntary action of the parties to each contract," that "governments not only do not but cannot determine the standard of deferred payments," and that when they appear to do so in that they define the meaning of the "dollar" in contracts they really fix the standard only in the sense that governments "make the wills of persons dying intestate." Without discussing this question at all in detail it may be well to ask, Is there not on the part of many parties to contracts absolutely no thought and often complete ignorance as to what the standard is, except the understanding that the obligation calls for so many dollars? If this is so, does not a government have within certain limits a very considerable power to fix the standard by which the ordinary daily business of the country shall be transacted? And is it not the tendency of all contracts, without very weighty reasons to the contrary, to be drawn in the medium of common business life? The author in considering the probable effects of legislation makes no distinction between the enactments of a single government and the joint action of several governments working together. Yet in view of the fact that monetary questions are now to so great an extent international as well as national this distinction clearly ought to be made.

The author next discusses the question, What constitutes a just monetary standard? It is not the purpose of this reply to

set up any ideal standard and claim for it complete justice. In fact it seems likely that no standard is possible which will not work hardship to a certain number of individuals, and hence that an absolutely just standard is impossible except in the sense that one may be adopted which will involve the least of possible evils. An attempt will be made to show (1) that the reasoning used to establish the justice of what is called a "fixed standard" contains fatal flaws, and (2) that the arguments put forward to prove the present gold supply adequate for monetary purposes are lacking in conclusiveness.

It will be best to state by way of explanation that the quantitative theory of money is here regarded as correct in its essential features. This theory is certainly not true in the exaggerated and mathematical form in which it has been stated by many of its opponents and by some of its friends. Dividing the amount of money by a certain number may not divide prices by exactly the same number, and an increase of standard money doubtless has a very different degree of influence from that of a like increase in substitutes for the standard. The quantitative theory must not be expected to explain directly all changes in the general level of prices, for very important oscillations in prices are caused by the wave-like movements of industrial prosperity and depression. With these qualifications, it is maintained that the quantity of money available for use does in the long run decidedly influence prices. There must be a relation between the money function—*the demand*—and the quantity of money—*the supply*—just as there is a relation between demand and supply in the case of all other things that have commercial value. If this were not true it would be impossible to have an automatic distribution of money between different countries, a process which is known to exist in fact as well as in theory. A certain minimum of standard money is required to serve as a basis for the superstructure of credit, and though it may be comparatively small, its function is just as important as that of the keystone of an arch.

Let us now examine the arguments by which the writer

attempts to show that the borrower does not lose by the existence of a "fixed standard." This is a standard which does not vary to prevent a fall in prices caused by a decrease in the cost of production. It may vary of course to prevent a fall of prices, when there is an increased monetary demand made upon the standard, as by an increase of population or the volume of trade. The expression "cost of production" is one of the most ambiguous and unsatisfactory phrases employed in economic discussion; but it may be inferred from the illustrations used that the writer means by a decrease in cost the saving caused by "discoveries and improvements." It is assumed by the writer that a considerable fall in general prices is caused by this decrease. Is this so? We must distinguish carefully between the effect upon prices directly and legitimately ascribable to decreased cost, and those indirect effects which are really caused by an increase in the monetary demand. An example will make this clearer. Suppose that through "discoveries and improvements" the cost of making clothing has been reduced fifty per cent. The only effect upon the prices of commodities which can be legitimately attributed to this cause is the lowering in the general average brought about by introducing a lower price of clothing. But besides this there is usually a very great indirect lowering of prices caused by the increase in the amount of clothing or other commodities to be exchanged. This effect produced by the multiplication of commodities is just as truly the result of an increased monetary demand, if it be occasioned by a decreased cost of production, as it would be if caused by an increase of population. Hence the "fixed standard" proposed would have to vary to prevent this fall in prices. Suppose as before that the cost of making clothing is reduced fifty per cent., but that no greater amount of clothing or other commodities is made in consequence. Will the full effect of the lower price of clothing be felt in the average price of commodities? Most certainly it will not. To make this plain let us suppose at first that money is used only for the exchange of commodities. In this case the general scale of prices could not be materially changed. Fifty

per cent. of the money formerly required by the clothing trade would now be released and would increase the supply of money available for the exchange of other commodities, thus increasing their prices and probably reacting on the price of clothing. The total amount of commodities to be exchanged would remain the same as before, that is, the money demand would be the same; and the same amount of money would be available for the exchange of commodities, that is, the supply would be the same; and average prices could not be greatly if any different. But the exhange of commodities is not the only use to which money is put. It is used in the payment of wages and salaries and for other minor purposes. With this change of hypothesis what will now happen? One-half the money formerly employed in the clothing trade, but now released from that use, will go to increase the supply to be used not alone for the exchange of other commodities, but for the performance of all other functions that may belong to money. It is presumable that this extra supply will be distributed somewhat in proportion to the importance of these various functions. Since the whole of this supply does not go to the service of commodities, it is evident that the average price of commodities including clothing must fall somewhat; but it is also evident that the full effect of the lower price of clothing will not be seen in these average prices. To what extent general prices will fall will depend upon the extent to which the released supply of money flows to other uses than that of the exchange of commodities, and it is possible that a small portion of metallic money may thus be transferred from monetary to industrial uses. But it may be well to suggest that the exchange of commodities is by far the greatest use to which money is put, and would naturally take a large share of this supply. It therefore seems reasonable to doubt whether the direct lowering of average prices by a decrease in the cost of production is very great. But in so far as this direct result is small, the distinction made by the author between his "fixed" and "declining" standards becomes proportionately of little practical value. The great decline in prices then which our

author attributes directly to a reduction in costs, finds a more adequate and reasonable explanation in the increased monetary demand indirectly created by that reduction. But we are by no means obliged to attribute the whole actual decline to either or both of these causes, for a considerable decline might have occurred in the last two decades, if the cost of production had not decreased.

But even if we grant the premise that the decline of prices is due to a lower cost of production, what shall we say to the following argument? A manufacturer is supposed to borrow $100,000 for fifty years to invest in a factory, and prices decline at the rate of one per cent. a year so that the $100,000 will buy at the end of the period twice the amount of commodities that it would at the beginning. The author's conclusion is that the borrower in being obliged to repay the $100,000, even though he will practically repay twice as many commodities as he received, will suffer no inconvenience, for in the mean time the productive power of his capital and the labor employed with it will have doubled. In this argument we find this remarkable statement: "At the end of the period the capital borrowed represents a productive power twice as great as it represented at the beginning of the period, just as the $100,000, if it had not been invested but hid away in a napkin, would represent double the purchasing power at the end of the period." Could any analogy be more unfortunate than that which compares this investment with the napkin affair? What really happens when a manufacturer borrows $100,000 to invest in a factory, excluding, as the author's reasoning necessarily does, the case of the man whose machines or processes are protected by patents or other means of monopoly? The $100,000 is immediately changed into the form of a factory with machines and raw materials, that is, into the form of commodities. Now by hypothesis the general scale of prices falls one per cent. a year. Why should not the commodities purchased with the borrowed capital fall in value as much as other commodities? In the general case supposed there is no possible reason why they should not. So what is to prevent a man's capital into which he puts $100,000 from con-

stantly dwindling until at the end of fifty years it will amount to only one-half of that sum? In this case how can the borrower repay $100,000 without feeling inconvenience? Unless it can be shown that the rate per cent. of return to capital increases in a remarkable manner as prices decline, there can be no answer to the question; and it is not very likely that this will be attempted either from a historical or from a theoretical standpoint. It is not here asserted that in order to avoid loss the borrower must repay only $50,000. That may or may not be so. But it is maintained that under the conditions cited he could not repay $100,000 without suffering serious inconvenience. The manufacturer's capital is not only invested in commodities which are liable to a decline in value, but much of it is in the form of machinery and appliances which are peculiarly liable to depreciation in value as the result of "discoveries and improvements." In fact a machine today worth hundreds of dollars may within a week be reduced to its value as old iron by the introduction of a new invention. The building used for the factory may be rendered almost valueless for future use by the introduction of a new process which requires more room or a building of a different shape. Has the author taken these facts into consideration? Moreover the item of interest must not be forgotten. Our manufacturer during the fifty years is still paying interest at the old rate on $100,000, although the average amount of capital of which he enjoys the use during that period is probably not far from $75,000. Most if not all of these considerations would apply equally well to the man who has borrowed capital to put into agriculture. What comfort is it to the farmer to know that he can produce a bushel of wheat with half the labor formerly required, if a reduction of 50 per cent. in the price of wheat has annihilated one-half the original value of his farm and he is still paying interest on debts contracted under a régime of much higher prices?

Leaving other conditions the same, our author now varies the example by supposing the existence of a "monetary system which fluctuates with commodities," so that although the costs of pro-

duction have been reduced one-half the $100,000 will buy at the end of the period only the same amount of commodities as at the beginning. His reasoning is as follows. "It appears that what for convenience may be called the unearned increment of capital remains with the borrower. During the fifty years the productiveness of the capital borrowed has doubled, and since prices have not fallen, the money value of the product and consequently of the capital has doubled. Therefore the borrower can pay back his whole debt with half his capital, keeping the other half or the unearned increment himself." Is this reasoning valid? It is stated that the average prices of commodities do not change. The manufacturer's $100,000 is invested wholly or chiefly in commodities. Why should the value of these commodities rise any more than the value of other commodities? Excluding patents and other monopolies as we must, we shall search in vain for an answer. How then can the manufacturer repay his loan and have half his capital left? By what magic does the $100,000 become $200,000? Will it be attempted to show that the extra rate of profit on the capital would be sufficient to produce this result?

Let us now see briefly how what is here called the unearned increment of capital is really distributed. The result of discoveries and inventions is without doubt an increased industrial product, which, so far as it is not taken by monopolies, is divided among entrepreneurs, laborers, land owners and capitalists according to certain laws of distribution which it is unnecessary to discuss here. Not only is there no reason why the capitalist should have the whole increment, but it is difficult to see why we should interfere at all with the laws of distribution in his favor. Indeed it may well be asked whether the increase of product is not as a rule due to the efforts of the producing classes in their capacity as producers, and not to any effort of the creditor classes in their capacity as creditors. Would not the producing classes then have in equity a prior claim to the increase? When the question is viewed in its social aspect, this argument acquires much greater force. Certainly we ought not

to go out of our way to increase the present inequality in the distribution of wealth.

The author next turns his attention to the effect of falling prices upon wages and the welfare of laborers. He concludes that a general decline in the prices of commodities will benefit laborers, for "when prices fall, real wages rise, *because money wages are not reduced*."

This argument might be extended in its scope. Why could we not go further and say: "When prices fall, money interest, money rents and money profits are not reduced; therefore real interest, real rents and real profits rise, and the capitalist, land-owning and rent-receiving classes are thereby benefited?" We could then imagine each class struggling to lower prices and expecting to be benefited in distribution at the expense of its fellow classes. It goes without saying that if any individual or class can have the cost of living reduced without a reduction of income, the result will be a gain. The only thing new in the above quoted statement is that "when prices fall money wages are not reduced," and for this little proof is given. There is of course some inertia in the case of wages as there is in the case of most other things economic and human; but it is hard to believe that the author really means what his statement seems to imply. Money wages have not only in many cases been reduced, but in some instances they have been annihilated. Laborers have undoubtedly been benefited by a fall in *special* prices, when that fall has affected the commodities which laborers consume most extensively; but the statement that a fall in general prices favors the laborer may be disproved in theory as well as discredited by an appeal to history. Discarding for present purposes the results of changes in the laboring classes themselves, we may say that the most effective way to raise real or money wages is to increase the demand for labor, and this cannot be done unless the conditions for entering upon business enterprises are kept favorable and general prosperity is thus secured. Unless entrepreneurs engage in business, wages will not be paid at all. Now there are few things that so effectually kill the spirit of enterprise

and make capitalists timid about investing as a régime of constantly falling prices. Our author avoids the question when he says: "It is absurd to suppose that there is any given level of prices at which alone capital can obtain its permanent and usual profit." It is absurd, but that is not the point of controversy. It is the process of change from a high to a low level that does the mischief. The statement that a constantly falling market is unfavorable to business enterprise has been so well attested by experience and so ably supported in theory by numerous writers that it is unnecessary to spend more time upon it. Now what must be the effect upon laborers, even though customary daily wages should not be reduced quite so fast as prices fall? Many of them must lose employment entirely, many must work for a reduced portion of time, and those fortunate enough to retain employment must at least partially support those in idleness. Under these circumstances it is more than probable that in spite of some inertia in daily money wages, yearly wages will be actually reduced, and it is the annual income which is of real importance.

In the remaining portion of the article we find a discussion of "cheap money" and "the appreciation of gold." Three propositions are examined: (1) one for an extensive issue of paper money by the government, (2) one for the free coinage of silver, and (3) one for the coinage of silver at a ratio to gold higher than the market ratio. There is found underlying each of these propositions the idea "that money ought to be cheaper or that prices ought not to fall." Space would not permit a defense of any of these propositions, even if it should seem desirable, but a few questions may be allowed. Why do monometallists pay so much attention to propositions tending toward cheaper money, while few of them exhibit the slightest concern when it is proposed to make money dearer, and many of them are doing their utmost to make it appear that it is impossible for money to become dearer? Is it less objectionable to cause the scale-beam to incline upward than to make it drop downward?

The conclusion is reached by the author that gold has not

appreciated either through an increased monetary demand made upon it or because of a change in the annual output. What reasons are given for this opinion? With a commendable apology, that time-honored friend of the monometallist, "decreased cost of production," is brought forward. Many readers will be inclined to agree with the author that this is becoming a little tiresome, not only from mere "repetition," but from an essential lack of validity. We have seen good reasons for thinking that the lowering of prices produced by this cause is comparatively slight, and have found no reason for believing that this slight result is beneficial to industry. Moreover, people have long been wondering why this cause should have acquired such a new and remarkable vigor about the year 1873. Were there no "improvements and discoveries" before that date quite or nearly as great as those made since?

As a proof that the monetary demand upon gold has not greatly increased of recent years, we are given an instructive talk upon the expansion of credit and the small amount of gold at present used in commercial transactions compared with the total sum of the media of exchange. With many of the statements made no one will disagree; but do they prove what the author desires to establish? Was there any providential arrangement by which the economies in the use of gold increased in the years following 1873 just in time to balance the increased demand caused by European nations and the United States changing to the gold standard? And have we any assurance that this arrangement is still in force and will be kept up in spite of a great increase in population and trade and the possible if not probable change of still other nations to the gold standard? Is there any reason for supposing that any sharp turn in the methods for economizing gold took place in 1873? Or does the author think that the amount of gold has little or nothing to do with prices? In view of the confusing and ambiguous statements often made, it may be well to suggest that some of our monometallist friends tell us plainly what they really mean on this matter. Would or would not the discovery of another California have any effect upon prices? And if India, China, Japan and

Mexico should change to the gold basis, do you think that the "expansion of credit" would prevent an increase in the monetary demand upon gold?

As a further proof that more gold is not wanted as money, the author says: "The consumption of gold in the arts almost equals the annual product....the consumption of gold in the arts, perhaps more than of any other commodity, is a matter of choice, and the amount consumed may vary indefinitely. If there were need for more gold currency, a portion at least of the new product would be sent to the mints for coinage." This is a valuable contribution upon the subject. We must straightway give notice to the industrial users of gold that we wish more of that metal as money and adjure them to cease their destructive inroads upon the annual product. But has it never been explained that the demand for gold ornaments sometimes increases with the money value of that metal? Aside from this, the industrial and monetary demands simply compete with each other. The one that bids the higher will get the gold. Now the fact that most of the gold goes to satisfy the industrial demand certainly does not show that the monetary demand is decreasing. It only shows that the industrial demand has been increasing faster than the monetary demand. The fact that one horse is winning in a race does not by any means prove that the second horse is not making good time.

As a last resort we are assured that the annual output of gold is actually increasing. Granted that it is and that it will continue to do so, what does it profit us if it does not increase fast enough? Under certain conditions you may apply an additional stream of water to a burning house every five minutes and yet not save the house. We shall await with interest any new reasons that may be offered to prove that the supply of gold is and always will be adequate to the demands made upon it; but, in view of the insufficiency of the reasons given by so acute and careful a writer as Mr. Cummings, may we not conclude that good reasons are not to be had in abundance?

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